**COMMONWEALTH OF VIRGINIA**

**At the relation of the**

**STATE CORPORATION COMMISSION**

**v.** **CASE NO. INS-2001-00264**

**SUPERIOR INSURANCE COMPANY,**
**Defendant**

**REPORT OF ALEXANDER F. SKIRPAN, JR., HEARING EXAMINER**

**May 3, 2002**

This rule to show cause concerns whether the Commission should suspend Superior's license to transact insurance in the Commonwealth. The Insurance Commissioner of Superior's state of domicile, Florida, has found that Superior made unauthorized payments to its parent totaling more than $35 million. Based on the Florida finding and upon Superior's operating results over the last few years, the Bureau maintains that further transaction of insurance by Superior in the Commonwealth may be hazardous to its policyholders, creditors, and the public.

**HISTORY OF THE CASE**

On October 9, 2001, the Commission issued an Order to Take Notice regarding Superior Insurance Company ("Superior," or "Defendant"), a foreign corporation domiciled in the State of Florida, pursuant to § 38.2-1038 of the Code of Virginia. The Order to Take Notice stated that the Insurance Commissioner of the State of Florida issued an order that found certain unauthorized payments totaling more than $35 M made by Superior to its corporate parent constituted an immediate hazard to the policyholders and the public, and demonstrated a lack of fitness or trustworthiness to transact insurance. In addition, the Order to Take Notice declared that Defendant's surplus as regards to policyholders declined from $29,598,500 on July 1, 2000, to $15,812,961 on June 30, 2001; and that Superior has sustained net losses of (i) $4,339,106 for the six months ended June 30, 2001, (ii) $6,557,258 for the calendar year ended December 31, 2000, (iii) $19,232,186 for the calendar year ended December 31, 1999, and (iv) $8,121,830 for the calendar year ended December 31, 1998. Based on this information, the Bureau of Insurance ("Bureau") recommended that the license of Superior to transact the business of insurance in the Commonwealth be suspended. Therefore, the Commission gave Superior notice that its license to transact the business of insurance in the Commonwealth of Virginia would be suspended, unless the Defendant requested a hearing.

Superior filed a timely request for a hearing. Consequently, on October 31, 2001, the Commission issued its Rule to Show Cause, which scheduled this matter for hearing on November 29, 2001, and assigned the matter to a hearing examiner.

On November 15, 2001, Superior filed a Motion for Continuance, asserting that Douglas Symons, chief executive officer of Symons International Group, Inc. ("Symons International"), the holding company for Superior, was unavailable to attend and testify at the scheduled hearing. Because of the importance of Mr. Symons to Superior's case, Superior requested a continuance. The Bureau had no objection to the requested continuance. A Hearing Examiner's Ruling dated November 19, 2001, rescheduled the hearing for February 12, 2002. Subsequently, Superior and the Bureau agreed upon a new hearing date. A Hearing Examiner's Ruling dated February 8, 2002, rescheduled the hearing for March 5, 2002.

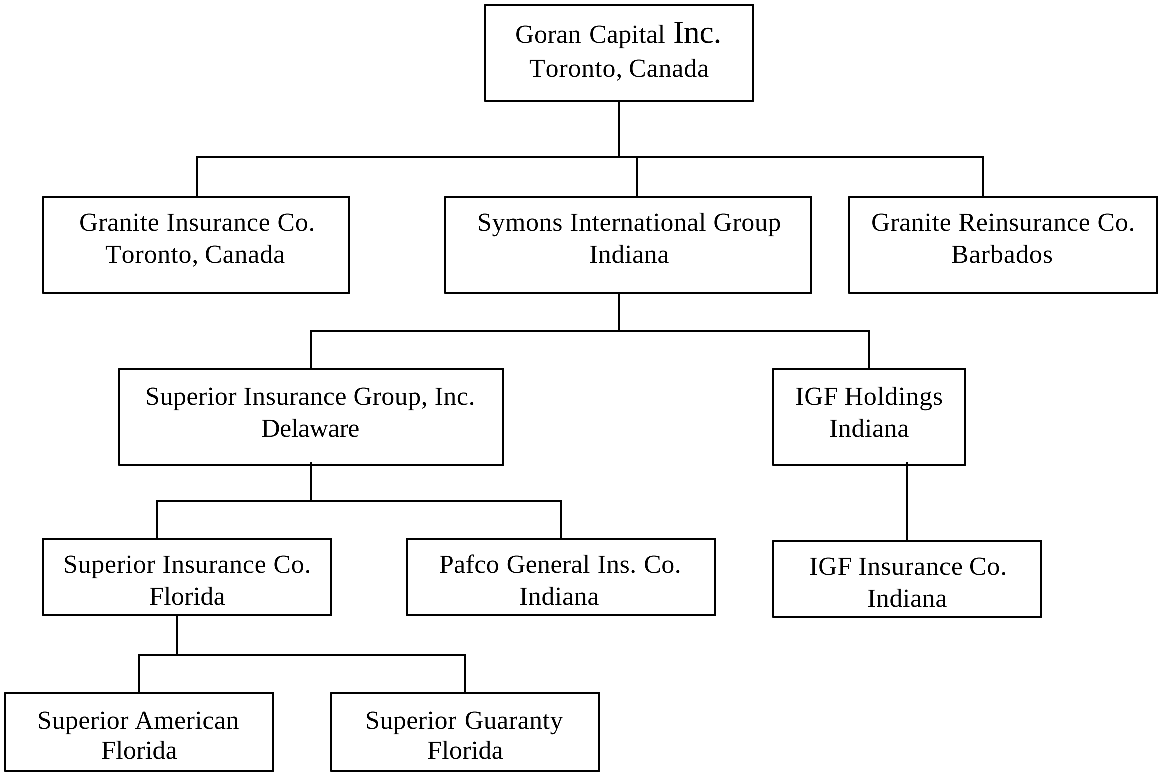
On March 5, 2002, the hearing was convened as scheduled. Ben R. Lacy, IV, Esquire, appeared on behalf of Superior. Pamela B. Beckner, Esquire, and Scott A. White, Esquire, represented the Bureau. Filed with this Report is a transcript of the hearing.

**SUMMARY OF THE RECORD**

Superior sells non-standard automobile insurance to individuals that are unable to secure insurance from traditional companies.[1] These policies typically are twelve-month or six-month policies, paid monthly, and provide the minimum level of required liability coverage.[2] In 2001, Superior collected $121 M in premiums and had 95,979 policies in force.[3] Though Superior is licensed in seventeen states, it earns 84% of its premiums from four focus states: California, Florida, Georgia, and Virginia.[4] In 2001, in Virginia, which Superior considers to be one of its more profitable states, the Defendant collected $20 M in premiums and had 16,445 policies in force.[5] In association with its Virginia operations, Superior operates claims offices in Alexandria and Norfolk, and has nineteen employees.[6]

In 1996, Symons International, a subsidiary of Goran Capital Inc. ("Goran"), purchased Superior.[7] The organizational chart below shows the structure of Goran and its subsidiaries, and the domicile of each company:[8]

[1] Yerant, Tr. at 132-33.
[2] *Id.* at 133.
[3] Exhibit 17, at 1.
[4] *Id.* at 2; Yerant, Tr. at 140.
[5] Exhibit 17, at 1; Reynolds, Tr. at 159.
[6] Yerant, Tr. at 142.
[7] Symons, Tr. at 95; Exhibit 18.
[8] Exhibit 18.




The Bureau first became concerned about Superior's financial condition in July 2000 upon receipt of a notice from Florida of its intent to issue a Cease and Desist Order against Superior and upon the receipt of a financial examination report from the State of Florida.[9] The intended Cease and Desist Order related to the payment of certain installment billing fees from Superior to Superior Insurance Group, Inc ("Superior Group").[10] In response to these concerns, the Bureau heightened its monitoring of Superior and requested Superior's Risk Based Capital ("RBC") plan.[11] Because the Bureau's concerns included holding company issues, the Bureau expanded its review to include other companies within the holding company system that were also licensed in Virginia.[12] This brought the Bureau's attention to IGF Insurance Company ("IGF").[13]

IGF, which is domiciled in Indiana, primarily wrote crop insurance, and in some states also offered non-standard auto insurance.[14] IGF sold only crop insurance in Virginia.[15] The Bureau found that IGF was "technically impaired" and issued an Impairment Order in October 2000.[16] According to Superior witness Symons, the impairment with IGF centered on

[9] Savoy, Tr. at 16.
[10] Neal, Tr. at 119; Exhibit 7, at 1.
[11] Savoy, Tr. at 17.
[12] *Id.*
[13] *Id.*
[14] Symons, Tr. at 96.
[15] *Id.*
[16] Savoy, Tr. at 17-18.

the reinsuring of its non-standard auto insurance through Pafco.[17] Because Pafco was not licensed in Virginia, reinsurance through Pafco reduced IGF's excess surplus.[18] In January 2001, the Indiana Insurance Department asked the Bureau to hold off taking any action.[19] Mr. Symons explained that the requested delay was to allow the company to sell its crop insurance business to another entity.[20] The sale of the crop insurance business occurred in June 2001.[21] Based on the IGF financial statements for June 30, 2001, the Bureau recommended that a Suspension Order be issued.[22] On August 30, 2001, the Commission issued its Order to Take Notice regarding IGF.[23] Because IGF was no longer transacting business in Virginia, IGF did not request a hearing or oppose the suspension of its license.[24] Thus, on September 24, 2001, the Commission entered its Order Suspending License of IGF.[25]

In the meantime, the Bureau continued to monitor Superior. In the summer of 2001, two events caused the Bureau to become more concerned with Superior's financial condition. First, the Bureau received Superior's June 30, 2001, quarterly financial statement on approximately August 15, 2001.[26] This statement showed a 50% reduction in excess surplus and an increase in premium volume in Virginia.[27] More specifically, the Bureau found that Superior's excess surplus declined from approximately $29.6 M on July 1, 2000, to approximately $15.8 M on June 30, 2001.[28] In addition, the Bureau became concerned by Superior's sustained losses, which were as follows:[29]

| Year | Net Losses |
|---|---|
| 1998 | ($8.1 M) |
| 1999 | ($19.2 M) |
| 2000 | ($6.5 M) |
| Six Months End June 30, 2001 | ($4.3 M) |

Second, the Bureau received the Florida Cease and Desist Order, entered by the Insurance Commissioner of the State of Florida on August 30, 2001 ("*Florida Order*"), regarding Superior's payment of finance and service fees to its corporate parent, Superior Group.[30] Among other things the order states:

[17] Symons, Tr. at 97; *See*, Savoy, Tr. at 19.
[18] Symons, Tr. at 97.
[19] Exhibit 1; Savoy, Tr. at 18; Symons, Tr. at 98.
[20] Symons, Tr. at 98.
[21] *Id.*
[22] Savoy, Tr. at 18.
[23] Exhibit 1.
[24] Symons, Tr. at 98.
[25] Exhibit 2.
[26] Savoy, Tr. at 21.
[27] *Id.*
[28] *Id.* at 25.
[29] *Id.*
[30] *Id.* at 21; Exhibit 7.

> Payment by [Superior] to [Superior Group] or any other member of the Goran holding company system, of the Finance and Service Fees discussed herein constitutes an immediate hazard to the policyholders and the public, and demonstrates a lack of fitness or trustworthiness to transact insurance. Further, such Finance and Service Fees constitute dividends subject to applicable requirements of the Insurance Code identified in this Order. [Superior] shall therefore immediately cease and desist from making any such payments until such time as it has filed all required documentation seeking, and has received from the Department in writing, approval for these payments.[31]

Superior witness Neal, an attorney that represents Superior in Florida regulatory matters, testified that Superior has appealed the *Florida Order.*[32] In addition, Mr. Neal provided background regarding the *Florida Order*, including a description of Florida procedures.[33] According to Mr. Neal, when the Florida Department of Insurance issues a notice of a decision, a formal hearing may be requested.[34] An independent Administrative Law Judge ("ALJ") from the Florida Division of Administrative Hearings conducts the formal hearing and enters a recommended order.[35] The recommended order then goes to the agency head, or in this case, the Insurance Commissioner, who enters a final order either adopting, rejecting, or modifying the recommended order.[36] However, Florida law requires the agency head to give different levels of deference to the ALJ's recommendations with regard to findings of fact, conclusions of law, and findings of fact infused with policy.[37]

In Superior's Florida case, the ALJ found that the finance and service fees were not dividends, but payments for services.[38] Nonetheless, because the Consent Order, under which Superior was operating prior to April 30, 2000, failed to provide for such payments, the ALJ held that Superior was required to either obtain retroactive approval for the payments or recover the payments through offsets to future fee payments to Superior Group.[39]

The Florida Insurance Commissioner rejected several of the ALJ's findings and recommendations, including that which found the finance and service fees not to be dividends.[40] Though the Florida Insurance Commissioner questioned the fitness and trustworthiness of Superior to transact insurance, Florida has taken no action against Superior's license to transact

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[31] Exhibit 7, at Ordering ¶ 4.
[32] Neal, Tr. at 121.
[33] *Id.* at 117-29.
[34] *Id.* at 118.
[35] *Id.*
[36] *Id.* at 118-19.
[37] *Id.* at 119.
[38] *Id.* at 119-20; Exhibit 7, at Discussion ¶ 10.
[39] Neal, Tr. at 120; Exhibit 7, at Discussion ¶ 10.
[40] Neal, Tr. at 121; Exhibit 7, at Discussion ¶ 10 and Ordering ¶ 4.

insurance.[41] Indeed, the next ordering paragraph in the *Florida Order* provides for a repayment schedule for the ***net*** finance and service fees.

> [Superior] is to obtain from [Superior Group] the immediate repayment of the net amount of approximately $15 million that was paid from 1997 through 1999, and any additional Finance and Service Fees paid thereafter. Alternatively [Superior] may request Department approval of a repayment schedule. If the Department determines in its sole discretion that the repayment schedule is in the best interest of policyholders and the public, such repayment schedule for the total amount of Finance and Service Fees that have been paid shall be implemented by [Superior] and [Superior] shall collect all such amounts from [Superior Group] in accordance therewith.[42]

Based on Superior's continuing losses and declines in excess surplus, and based on the Florida Insurance Commission's findings, especially Superior's lack of fitness or trustworthiness to transact insurance, the Bureau recommended that a Suspension Order be issued.[43] As a result, on October 9, 2001, the Commission issued its Order to Take Notice to Superior, which initiated this case.[44]

At the hearing, the Bureau discussed other information that it maintained supported a finding that further transaction of insurance in the Commonwealth by Superior was hazardous to its policyholders, creditors, and the public. This other information included: (i) financial statements for Goran and Symons International,[45] (ii) the 2001 annual statement for Superior,[46] (iii) recent actions taken by Illinois and Texas against Superior,[47] and (iv) Florida's report on its financial examination of Superior as of December 31, 1999.[48]

Bureau witness Savoy testified that one of the factors to consider in determining whether an insurer's financial condition may be deemed to be hazardous to policyholders, creditors, or the general public is whether any affiliate is insolvent or threatened with insolvency.[49] In this regard, Ms. Savoy pointed to several items of concern in the financial statements for Goran and Symons International. For example, in its 10-Q dated September 30, 2001, Goran reported stockholders' deficit of $78,332,000.[50] Also, Ms. Savoy expressed concerns over two of the notes provided in the Management Discussion and Analysis section of Goran's 10-Q. One note

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[41] Neal, Tr. at 122-23.
[42] Exhibit 7, at Ordering ¶ 5.
[43] Savoy, Tr. at 21.
[44] *Id.* at 21-22; Exhibit 3.
[45] Savoy, Tr. at 36-43; Exhibit 9; Exhibit 10.
[46] Savoy, Tr. at 44-46; Exhibit 11.
[47] Savoy, Tr. at 47-53; Exhibit 12; Exhibit 15.
[48] Savoy, Tr. at 30-35; Stolte, Tr. at 74; Exhibit 8.
[49] Savoy, Tr. at 35; 14 VAC 5-290-30 (10).
[50] Savoy, Tr. at 37; Exhibit 9, at 3.

concluded with the statement that "[f]ailure to resolve issues with the [Indiana Department of Insurance] and the [Florida Department of Insurance], and with other regulators, in a manner satisfactory to the Company could impair the Company's ability to execute its business strategies or result in future regulatory actions or proceedings that could have a material adverse effect on the Company's operations."[51] The other note described $135 M in trust preferred securities issued by Symons International with annual interest payments of 9.5% that will be repaid through a trust funded by Superior's parent, Superior Insurance Group.[52]

As to Symons International, Ms. Savoy testified that in its 10-Q dated September 30, 2001, Symons International reported stockholders' deficit of $138,077,000.[53] In addition, Ms. Savoy stated that the Symons International 10-Q contained many of the same notes as the Goran 10-Q referencing regulatory actions in Indiana, Florida, and other states, and discussing the same preferred securities.[54]

Another factor used by the Bureau to determine if an insurer is in hazardous financial condition is whether the company has or will experience cash flow or liquidity problems in the foreseeable future.[55] Though the Bureau had access to Superior's 2001 annual statement for less than a day, its initial review found that Superior lost $8,681,211 for 2001, and that Superior's surplus declined from $21,982,628 at the beginning of the year to $16,663,966 at the end of the year.[56] A capital contribution of $5,650,000, during 2001, kept the ending surplus balance from being even lower.[57] The five-year decline in surplus was as follows:[58]

| **Year** | **Ending Surplus** |
|---|---|
| 1997 | $65,146,463 |
| 1998 | $57,571,245 |
| 1999 | $34,199,727 |
| 2000 | $21,982,628 |
| 2001 | $16,663,966 |

Based on its review of Superior's 2001 annual statement, and based on the results reported in the 10-Qs for Goran and Symons International, Ms. Savoy maintained that Superior will experience cash flow or liquidity problems.[59] Ms. Savoy reasoned that the interest on the $135 M in trust preferred securities reported on the 10-Qs for Goran and Symons International

51 Savoy, Tr. at 38; Exhibit 9, at 17.
52 Savoy, Tr. at 39; Exhibit 9, at 17.
53 Savoy, Tr. at 42; Exhibit 10, at 3.
54 Savoy, Tr. at 42-43.
55 *Id.* at 45; 14 VAC 5-290-30 (17).
56 Savoy, Tr. at 44; Exhibit 11, at 4, lines 21 and 36.
57 Savoy, Tr. at 44; Exhibit 11, at 4, line 30.1.
58 Exhibit 11, at 22, line 26.
59 Savoy, Tr. at 45-46.

will be paid ultimately by Superior.[60] Ms. Savoy found such payments coupled with Superior's current financial condition "would render [Superior] impaired."[61]

Bureau witness Stole was more forceful in his opinions concerning the likelihood of liquidity problems in the foreseeable future. According to Mr. Stole, "there is a reasonable expectation, given [Superior's] current financial position and the way it is trending, that it will become not only impaired, but insolvent."[62]

As disclosed in the 10-Qs for Goran and Symons International, other states have taken regulatory actions against Superior. In its review of actions taken by other states, the Bureau discovered that on October 17, 2001, the Illinois Department of Insurance entered a Stipulation and Consent Order in regards to Superior ("*Illinois Order*").[63] In the *Illinois Order*, Superior agreed not to write any new or renew any policies in Illinois without the prior written approval of the Director of Insurance.[64] The *Illinois Order* also states that based on the financial statements for the period December 31, 2000, "Superior does not dispute the Department's findings against it pursuant to Sections 119(1)(c) and 119(2) of the Illinois Insurance Code."[65] In essence, Superior did not dispute that it "is in such a financial condition that its further transaction of business in this State would be hazardous to policyholders and creditors in this State and to the public."[66]

In Texas, on July 30, 2001, Superior filed a certified resolution of its board of directors advising the Texas Department of Insurance that it would cease writing insurance policies in the State of Texas, immediately.[67] The resolution notes that the Texas Department of Insurance informed Superior that if it ceased writing insurance policies in Texas, the Texas Department of Insurance would forbear any regulatory action.[68]

Finally, on December 26, 2001, the Bureau received a copy of the Florida Department of Insurance's Report on Examination as of December 31, 1999, for Superior ("Florida Report").[69] Ms. Savoy testified that the Florida Report raised concerns.[70] First, the Florida Department of Insurance found that many of the operational weaknesses and adverse findings identified in examinations conducted in 1997 and for the period ending June 30, 1999, continued to exist.[71] Second, in discussing Superior's marked decrease in net income since 1996, the Florida Department of Insurance found that the losses represent "an adverse trend that, if it continues,

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[60] *Id.*
[61] *Id.* at 46.
[62] Stole, Tr. at 77.
[63] Exhibit 12.
[64] Savoy, Tr. at 48; Exhibit 12, at 2.
[65] Savoy, Tr. at 48; Exhibit 12, at 1.
[66] Exhibit 13, at 7; 215 ILCS 5/119(1)(c).
[67] Savoy, Tr. at 52; Exhibit 15.
[68] *Id.*
[69] Exhibit 8.
[70] Savoy, Tr. at 34.
[71] *Id.*; Exhibit 8, at 3.

will render [Superior] impaired and, eventually, insolvent."[72] As Mr. Stole summarized the Florida Report, "I can easily say, in my 18 and a half years' experience, that this is one of the worst financial condition exam reports that I have seen."[73]

Based on this information, the Bureau recommended that Superior's license be suspended due to its hazardous financial condition.[74] Such an action would prohibit Superior "from writing any new business and its insurance agent's authority would be suspended."[75] Mr. Stole asserted that to prevent harm to the policyholders, creditors and general public, only solvent companies and companies not in a financially hazardous condition should be permitted to write insurance in the Commonwealth.[76] Mr. Stole provided an example of the dangers to the public resulting from failure to suspend the license of an insurance company that will become insolvent.

> [I]f an insurance company becomes insolvent, there is a Guaranty Association, the Virginia Property and Casualty Guaranty Association, and its current limits of liability are 300,000. . . . In today's environment, especially a company that is writing sub-standard auto, it's not unreasonable to imagine a case where a policyholder may have a judgment against them in excess of the 300,000 limit, causing . . . a third party that was injured to not get their claim paid entirely, and also for the policyholder to have a judgment against them.[77]

Superior did not dispute that it was a troubled company as of December 31, 1999. Superior witness Yerant, its president, joined Superior on January 8, 2000.[78] Mr. Yerant described the condition of Superior when he joined, as:

> pretty much a mess. I mean, we were unable to produce financials. We were unable to issue policies. Our claims were not very well handled. And there was – it was a pretty bad situation, I would say.[79]

Mr. Yerant explained that he was hired "to figure out how to fix [Superior], correct the operational problems, and make [Superior] profitable."[80] To do this, Mr. Yerant replaced the entire management group, rebuilt the Operations Department, and implemented a new processing system, which offers point-of-sale information to Superior's agents.[81] Because of the

[72] Savoy, Tr. at 34-35; Exhibit 8, at 32.
[73] Stole, Tr. at 74.
[74] *Id.* at 73.
[75] *Id.*
[76] *Id.* at 74.
[77] *Id.* at 76-77.
[78] Yerant, Tr. at 131.
[79] *Id.*
[80] *Id.*
[81] *Id.* at 134.

transactional nature of non-standard auto insurance, Mr. Yerant emphasized the importance of the new point-of-sale processing system, which should permit Superior to reduce high write-offs, provide its independent agents with more accurate price quotes, and assess risks more accurately.[82]

In addition, in contrast to the rapid premium growth in 1998 and 1999, Superior, under Mr. Yerant, has reduced gross premiums from $159 M in 1999 to $121 M in 2001.[83] Also, Superior has increased rates aggressively and has moved to more six-month policies.[84] Moving to six-month policies shortens the time for realizing the full effect of rate increases.[85] When asked about the $8.6 M loss Superior recorded for 2001, Mr. Yerant pointed out that the size of the loss declined in 2001 and that he expects "improvement[] to continue in the year 2002."[86]

Superior witness Hafling, an actuary, offered details about the liquidity of Superior and the impact of Mr. Yerant's changes on financial results.[87] Mr. Hafling focused on Superior's loss ratio, which he defined as earned premiums less claims, including defense costs.[88] As Mr. Hafling explained, the loss ratio is an acceptable way of tracking the profitability of an insurance company because most other expenses are relatively constant as a percentage of premiums.[89] Mr. Hafling showed that in 1998 and 1999, Superior's loss ratio increased from about 70% to about 82%.[90] This deterioration in Superior's loss ratio occurred when Superior cut rates to meet competition.[91] In contrast, by now increasing rates, and by keeping the growth in the cost of claims to roughly the rate of inflation, or about 2.9%, Mr. Hafling estimates that Superior's loss ratio should decline throughout the first half of 2002 and flatten out at about 64.5% during the second half of 2002.[92] Mr. Hafling testified that a 64.5% loss ratio would give Superior, after paying all other costs, an operating profit of 5% of premiums.[93]

In addition, Mr. Hafling addressed liquidity from an Insurance Regulatory Information System ("IRIS") ratio perspective and from a cash flow perspective. IRIS ratios are a series of quantitative measurements designed by the National Association of Insurance Commissioners ("NAIC") to help identify insurance companies that need additional attention.[94] Two of the twelve IRIS ratios focus on liquidity.[95] The first liquidity ratio is the ratio of liabilities to liquid

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[82] *Id.* at 134-36.
[83] *Id.* at 137.
[84] *Id.* at 138.
[85] *Id.* at 139.
[86] *Id.* at 151-152.
[87] Hafling, Tr. at 163-183.
[88] *Id.* at 165.
[89] *Id.*
[90] *Id.*; Exhibit 21, at 1.
[91] Hafling, Tr. at 166.
[92] *Id.* at 166-70.
[93] *Id.* at 170.
[94] *Id.* at 172.
[95] *Id.*

assets.[96] As of December 31, 2001, Superior had a ratio of liabilities to liquid assets of 100.5, which is in the normal range, or less than 105.[97] The second liquidity ratio is the ratio of agents' balances to liquid assets. As of December 31, 2001, Superior had a ratio of agents' balances to liquid assets of 7.7, which also is in the normal range, of less than 40.[98]

Finally, Mr. Hafling explained why Superior has experienced negative cash flows over the past few years.[99] Generally, an insurance company collects cash as it earns premiums.[100] The company incurs claims costs when policyholders have accidents.[101] However, the company does not pay for claims until it receives the actual repair or medical bills and all disputes are settled.[102] The company invests funds in stocks and bonds during the delay in timing between the collection of premiums and the payment of claims.[103] When a company is growing rapidly, cash flow is positive and assets build up rapidly.[104] When a company is declining in volume, cash flow becomes negative and the company sells assets to pay for old claims.[105] According to Mr. Hafling, Superior's earned premiums have been declining since 1997.[106] Therefore, Mr. Hafling argued that the negative cash flow Superior has been experiencing lately does not indicate that it will fail to pay future claims.[107] Indeed, Mr. Hafling opined that Superior will be able to meet its obligations to all of its insureds in Virginia.[108]

Furthermore, Superior addressed several other concerns raised by the Bureau. These concerns include: (i) the decline in surplus for Superior,[109] (ii) the trust preferred securities issued by Symons International,[110] and (iii) recent regulatory actions taken by Illinois and Texas.[111]

Superior witness Haskell verified that Superior's decline in surplus for 2001 was less than the 50% threshold for regulatory action.[112] Moreover, Mr. Haskell maintained that Superior's surplus has remained relatively flat for the past four quarters, with a slight increase in surplus between June 2001 and December 2001.[113] Following the NAIC developed risk based

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[96] *Id.*
[97] *Id.* at 172-73.
[98] *Id.* at 173.
[99] *Id.* at 173-78.
[100] *Id.* at 174.
[101] *Id.*
[102] *Id.*
[103] *Id.* at 175-76.
[104] *Id.* at 176.
[105] *Id.*
[106] *Id.*
[107] *Id.* at 178.
[108] *Id.*
[109] Haskell, Tr. at 188-200.
[110] Symons, Tr. at 101-02, 108, 110-11, 114; Exhibit 16.
[111] Symons, Tr. at 103-04.
[112] Haskell, Tr. at 190.
[113] *Id.*; Exhibit 23, at 2.

capital ("RBC") calculation and interpretation,[114] as of December 31, 2001, Superior had an RBC ratio of 298.[115] This places Superior above any of the four defined levels of action.[116]

Superior witness Symons provided some additional information concerning the trust preferred securities issued by Symons International. The trust preferred securities will mature in approximately twenty-six years and requires Symons International to pay interest into a trust at an annual rate of nine and a half percent.[117] However, Symons International may defer interest payments for up to five years, or ten consecutive semi-annual payments.[118] Symons International began deferring the semi-annual interest payments in February 2000.[119] In addition, Mr. Symons testified that "[Goran] has repurchased $67 million of this $135 million trust preferred [securities] already."[120]

In regard to the regulatory actions taken by Illinois and Texas, Mr. Symons observed that both orders were consent orders.[121] Superior chose to cease writing insurance in both states and at the time of the orders, both states were in a run-off mode.[122]

Finally, Mr. Symons assessed what would happen if the Commission were to suspend Superior's license.

> We believe that by the actions here, which are unwarranted, in suspending the license of Superior, that it then will become a catalyst to other states to take similar actions. And more than likely, [Superior] will cease to exist. It can't if other states are going to do the same thing. No other state has said that they have an issue with the Company continuing to write business where it currently writes business.[123]

**DISCUSSION**

Virginia Code §§ 38.2-1038 and 1040 authorize the Commission to suspend or revoke the license of any insurance company to transact insurance in the Commonwealth if it finds that the company is in a condition that any further transaction of business in this Commonwealth is hazardous to its policyholders, creditors, and the public in this Commonwealth. Seventeen specific standards for determining whether an insurance company is in a hazardous condition are provided in regulations codified as 14 VAC 5-290-30. Any standard, either singly or a

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[114] *See*, Virginia Code § 38.2-5500 *et seq.*
[115] Haskell, Tr. at 196; Exhibit 23, at 8.
[116] *Id.*
[117] Symons, Tr. at 100-01.
[118] *Id.* at 101; Exhibit 16, at 22.
[119] Exhibit 9, at 8.
[120] Symons, Tr. at 114.
[121] *Id.* at 103-04.
[122] *Id.*
[123] *Id.* at 106.

combination of two or more, may be considered in determining whether an insurance company is in a hazardous condition.[124] On brief, the Bureau asserted that it presented clear and convincing evidence that Superior currently meets three of the standards, namely 14 VAC 5-290-30 (1), (10), and (17).[125] In addition, the Bureau argued that the Commission may consider the standard contained in 14 VAC 5-290-30 (7).

Superior argued that it is not in a hazardous financial condition.[126] Moreover, Superior contended that the Bureau failed to meet a clear and convincing standard and failed to provide "objective, specific, sound financial reasons to support its opinion that the current financial condition of Superior is hazardous."[127]

To meet a clear and convincing standard, the Bureau must provide:

> that measure or degree of proof which will produce in the mind of the trier of facts a firm belief or conviction as to the allegations sought to be established. It is intermediate, being more than a mere preponderance, but not to the extent of such certainty as is required beyond a reasonable doubt as in criminal cases. It does not mean clear and unequivocal.[128]

Following this legal standard, each of the standards of 14 VAC 5-290-30 raised by the Bureau is examined below. After considering each standard on an individual basis, the standards will be considered on a combined basis.

**14 VAC 5-290-30 (1) Adverse Findings.**

14 VAC 5-290-30 (1) provides that in determining whether an insurer's financial condition, method of operation, or manner of doing business in this Commonwealth might be deemed to be hazardous to policyholders, creditors, or the general public, the Commission may consider:

> Adverse findings resulting from any financial condition or market conduct examination conducted pursuant to Article 4 (§ 38.2-1317 et seq.) of Chapter 13 of Title 38.2 of the Code of Virginia or any inspection authorized by the general provisions of § 38.2-200, including inspections of financial statements filed pursuant to §§ 38.2-1300, 38.2-1301, 38.2-1316.2, 38.2-1316.3, 38.2-4811 or 38.2-5103 of the Code of Virginia, or reported in any examination or other information submitted pursuant to § 38.2-5103 of the Code of Virginia;

[124] 14 VAC 5-290-30.
[125] Bureau Brief at 4.
[126] Superior Brief at 1.
[127] *Id.* at 5.
[128] *Walker Agcy. & Aetna Cas. Co. v. Lucas*, 215 Va. 535, 540-41 (1975) (citation omitted).

The Bureau submitted that adverse findings in the *Florida Order* and Superior's financial statements "caused the Bureau concern and supported the Bureau's belief that Defendant was in a hazardous financial condition, which led to the issuance of the Order to Take Notice."[129] Subsequent to the Order to Take Notice, the Bureau received the Florida Report, which was for the period ending December 31, 1999.[130] The Bureau found several adverse findings in the Florida Report, including that Superior failed to correct operational problems, which were the subject of earlier reports, and a deteriorating trend in net income.[131]

Superior averred that the *Florida Order* contradicted the findings of the Florida ALJ and is currently under appeal.[132] Superior objected to either the use or reliance on the Florida Report because it was not disclosed to Superior pursuant to its discovery request.[133]

As described above, the *Florida Order* concerns the appropriateness of the payment of $35 M in finance and service fees by Superior to its parent, Superior Group.[134] In its *Florida Order* the Florida Insurance Commissioner finds these finance and service fees to be unauthorized dividends and directs Superior Group to refund to Superior $15 M, which is the amount of dividends paid to Superior Group by Superior, net of capital transfers Superior Group made to Superior.[135] Though the *Florida Order* found the payment of unauthorized finance and service fees "constitutes an immediate hazard to the policyholders and the public, and demonstrates a lack of fitness or trustworthiness to transact insurance," the action taken by the Florida Insurance Commissioner was to order Superior to cease and desist from making such payments until it receives written approval and to obtain a refund from Superior Group of the net payments, or $15 M.[136] In regards to the refund from Superior Group, the Florida Insurance Commissioner offered the possibility of a repayment schedule.[137]

In contrast to establishing a repayment schedule for the payment of unauthorized fees, the Bureau recommends that the Commission suspend Superior's license to transact insurance within the Commonwealth. I find that the *Florida Order* should be confined to the narrow issue of the appropriateness of the payment of finance and service fees. That is, the *Florida Order* establishes the payment of such fees to be a hazard. And, the *Florida Order* serves to remove this hazard by ordering them stopped and refunded. Thus, the payment of these fees no longer remains a hazard to the Commonwealth.

As to the Florida Report, because it relates to findings for the period ended December 31, 1999, its use in determining current or future hazards to the Commonwealth is

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[129] Bureau Brief at 7.
[130] *Id.* at 8; Stole, Tr. at 90.
[131] Savoy, Tr. at 34-35; Exhibit 8, at 3, 32.
[132] Superior Brief at 2.
[133] *Id.*; Tr. at 31-33.
[134] Exhibit 7.
[135] *Id.* at Ordering ¶¶ 4-5.
[136] *Id.*
[137] *Id.* at Ordering ¶ 5.

limited. Furthermore, through the testimony of Mr. Yerant, Superior has demonstrated that since December 1999, it has made significant changes in its management structure and in the operation of its business.[138] The Bureau presented no evidence concerning the continued relevance of the Florida Report's adverse operational findings.

Therefore, I find the Bureau failed to present clear and convincing evidence that Superior is in hazardous condition based singly on the standards of 14 VAC 5-290-30 (1).

**14 VAC 5-290-30 (7) 50% Decrease in Excess Surplus.**

14 VAC 5-290-30 (7) provides that in determining whether an insurer's financial condition, method of operation, or manner of doing business in this Commonwealth might be deemed to be hazardous to policyholders, creditors, or the general public, the Commission may consider:

> Whether the insurer's excess of surplus to policyholders over and above an insurer's statutorily required surplus to policyholders has decreased by more than 50% in the preceding 12 month period or any shorter period of time;

The Bureau examined financial statements and found that for the period July 1, 2000 to June 30, 2001, Superior's excess surplus declined by more than 50%.[139] Moreover, Superior's surplus has declined precipitously over the last few years, dropping from \$65.1 M at year-end 1997 to \$16.7 M at year-end 2001.[140]

However, for the twelve months ended December 31, 2001, Superior's excess surplus declined by 33%.[141] Superior witness Haskell testified that \$1.7 M of the \$5.3 M reduction in excess surplus for 2001 was attributed to a one-time change in accounting for admitted assets.[142] Without this change in accounting, Superior's excess surplus would have declined by only \$3.6 M, or 25% for 2001.[143] Furthermore, Mr. Haskell presented a graph that showed most of the decline in excess surplus occurred between December 2000 and March 2001.[144] Indeed, Mr. Haskell declared that between June 2001 and December 2001, Superior's excess surplus increased from \$9.8 M to \$10.7.[145]

Based on the results for 2001, Superior meets the standard of 14 VAC 5-290-30 (7). But concern for the decrease in Superior's surplus should not end here. As Bureau witness Savoy

[138] Yerant, Tr. at 131-144.
[139] Bureau Brief at 7-8; Savoy, Tr. at 25.
[140] Exhibit 11, at 22, line 26.
[141] Exhibit 23, at 1.
[142] *Id.*; Haskell, Tr. at 190.
[143] Exhibit 23, at 1.
[144] *Id.* at 2.
[145] *Id.*

pointed out, during 2001 Superior received a capital infusion of $5.6 M.[146] Without this capital infusion, Superior's decline in excess surplus would have been more severe. That is, Superior's decline in excess surplus would have been $10.9 M,[147] or a decline of approximately 68%.[148] Even with the elimination of the accounting change, the decline in excess surplus would have been $9.2 M,[149] or 64%.[150] Mr. Haskell stated that additional capital contributions would be made in the future, if necessary, to remain above any minimum level surplus required in any jurisdiction in which Superior writes insurance.[151] Consequently, future compliance with the standard of 14 VAC 5-290-30 (7) will hinge on Superior's profitability and the ability of its parent companies to raise capital.

**14 VAC 5-290-30 (10) Insolvent Affiliate.**

14 VAC 5-290-30 (10) provides that in determining whether an insurer's financial condition, method of operation, or manner of doing business in this Commonwealth might be deemed to be hazardous to policyholders, creditors, or the general public, the Commission may consider:

> Whether any affiliate, subsidiary or reinsurer is insolvent, threatened with insolvency, or delinquent in payment of its monetary or other obligations;

The Bureau argued that Goran and Symons International are affiliates that are threatened with insolvency.[152] Superior maintained that there is no affiliate, subsidiary, or reinsurer associated with Superior that is insolvent or delinquent in payments or monetary obligations.[153] Moreover, Superior asserted that Goran was not a subsidiary or affiliate of Superior.[154]

Affiliate, as defined in § 38.2-1322 of the Virginia Code is a company "that directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the person specified." Based on the organizational charts and testimony presented, I find Goran and Symons International to be affiliates of Superior.

As evidence that Goran is threatened with insolvency, the Bureau pointed to

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[146] Savoy, Tr. at 44; Exhibit 11, at 4, line 30.1.
[147] $10.9 M = $5,650,000 capital infusion per Exhibit 11, at 4, line 30.1, rounded to $5.6 M, plus $5,318,662 change in excess surplus per Exhibit 23, at 1, rounded to $5.3 M.
[148] 68% = $10.9 M divided by $15,982,628 excess capital at 12/31/00, per Exhibit 23, at 1, rounded to $16.0 M.
[149] $9.2 M = $5,650,000 capital infusion per Exhibit 11, at 4, line 30.1, rounded to $5.6 M, plus $3,614,662 change in excess surplus per Exhibit 23, at 1, rounded to $3.6 M.
[150] 64% = $9.2 M divided by $14,278,628 adjusted excess capital at 12/31/00, per Exhibit 23, at 1, rounded to $14.3 M.
[151] Haskell, Tr. at 200.
[152] Bureau Brief at 9-13.
[153] Superior Brief at 3; Symons, Tr. at 107.
[154] Superior Brief at 4.

Goran's 10-Q dated September 30, 2001, that showed a stockholders' deficit of $78.3 M.[155] As of September 30, 2001, Goran had total assets of $570.3 M and total liabilities of $554.2 M.[156] Further, from a cash flow perspective, for the nine months ended September 30, 2001, Goran reports a net increase in cash and cash equivalents of $36.5 M.[157] Therefore, on the face of the financial data presented in Goran's 10-Q, Goran does not appear to be insolvent as of September 30, 2001.

But Goran's financial condition, especially given its stockholders' deficit and operating losses, gives Goran no room for error. Thus, the notes to the financial statements about possible adverse regulatory actions cannot be dismissed, as Mr. Symons attempts, as worst-case scenarios placed in the 10-Q to protect officers and directors.[158] The key to the possibility of adverse regulatory actions is that "the insurance company subsidiaries' losses, adverse trends and uncertainties . . . continue to be matters of concern to the domiciliary and other insurance regulators."[159] That is, to a large extent, the degree to which Goran may be threatened with insolvency relates directly to the operating performance of Superior and Goran's other insurance companies. This is also true concerning the trust preferred securities, which are to be funded by the insurance companies.[160] Consequently, the Bureau's argument is completely circular. In essence, it argues that Superior is in a hazardous financial condition because its parent is threatened with insolvency because Superior is in a hazardous financial condition. Therefore, I find that standing by itself, the Bureau failed to present clear and convincing evidence that Superior is in hazardous financial condition because Goran is threatened with insolvency.

The analysis is similar concerning Symons International. As shown in its September 2001, 10-Q, Symons International had a stockholders' deficit of $138.1 M, total assets of $237.0 M, and total liabilities of $240.1 M.[161] For the nine months ended September 2001, Symons International had an increase in cash and cash equivalents of $24.2 M.[162] The 10-Qs for both Symons International and Goran contain notes on possible adverse regulatory actions and a discussion of the trust preferred securities.[163]

Most of the difference between Goran and Symons International's balance sheet positions can be attributable to the trust preferred securities. Symons International's balance sheet contained $135 M for the trust preferred securities, as well as a $29.4 M liability for distributions payable on preferred securities.[164] Goran's balance sheet reflected $94.5 M for the trust preferred securities and only $19.9 M for the liability for distributions payable on preferred

[155] Bureau Brief at 11-12.
[156] Exhibit 9, at 3.
[157] *Id.* at 7.
[158] Symons, Tr. at 100.
[159] Exhibit 9, at 17.
[160] *Id.*
[161] Exhibit 10, at 3.
[162] *Id.* at 6.
[163] Savoy, Tr. at 42.
[164] *Id.* at 3.

securities.[165] The reason for the difference in amounts relating to the trust preferred securities appears to be that as of September 2001, Goran had repurchased $40.5 M[166] of the trust preferred securities. Indeed, Superior witness Symons testified that as of the date of the hearing, Goran had repurchased $67 M of the $135 M trust preferred securities.[167]

Therefore, I find that the Bureau failed to present clear and convincing evidence that Superior is in a hazardous condition based singly on the standards of 14 VAC 5-290-30 (10).

**14 VAC 5-290-30 (17) Cash Flow/Liquidity.**

14 VAC 5-290-30 (17) provides that in determining whether an insurer's financial condition, method of operation, or manner of doing business in this Commonwealth might be deemed to be hazardous to policyholders, creditors, or the general public, the Commission may consider:

> Whether the company has experienced or will experience in the foreseeable future cash flow and/or liquidity problems.

The Bureau asserted that based on a review of the 10-Qs for Goran and Symons International, the Florida Report, and the 2001 annual report for Superior, the Defendant will experience cash flow or liquidity problems in the foreseeable future.[168] Superior responded with a series of witnesses that explained why Superior has experienced negative cash flows and described recent changes designed to make Superior a profitable company.

The trust preferred securities figured prominently in the Bureau's concerns regarding foreseeable future cash flow or liquidity problems.[169] As the note to Goran's 10-Q stated, "[t]he obligations of the [trust preferred securities] are funded from [Symons International's] non-standard automobile management company."[170] Thus, the Bureau contended that the interest payments on the trust preferred securities of $13 M per year ultimately must be borne by Superior.[171] Currently, Symons International is deferring payment of interest, which they are permitted to do by the trust preferred securities.[172] On brief, the Bureau argued deferred interest could reach approximately $84 M when it would become due and payable in 2005.[173] The Bureau submitted that because Superior now has approximately $16 M in surplus, payment of interest for only one year could render Superior impaired.[174]

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[165] Exhibit 9, at 3.
[166] $40.5 = $135 M minus $94.5 M.
[167] Symons, Tr. at 114.
[168] Bureau Brief at 14.
[169] *Id.* at 14-15.
[170] Exhibit 9, at 17.
[171] Bureau Brief at 14.
[172] Exhibit 9, at 8; Exhibit 16, at 22.
[173] Bureau Brief at 14.
[174] *Id.* at 15.

I find the Bureau's concerns related to the trust preferred securities to be overstated for two reasons. First, as the actions taken by the Florida Insurance Department demonstrate, payment of interest on the trust preferred securities is subject to regulatory approval. The *Florida Order* demonstrates that the Florida Insurance Department is unlikely to approve such payments. Second, Goran already has repurchased almost half of the trust preferred securities. Thus, by the end of the five-year deferral period, most, if not all of the interest owed related to these instruments may be owed to Goran.

In addition, the Bureau points to Superior's recent history of negative cash flows and its sale of invested assets as evidence that "future cash flow most likely also will be negative."[175] However, as Superior witness Hafling explained, there is a timing difference between the collection of cash premiums and the payment of claims.[176] This timing may cause cash flow to be negative when premium volumes decline, as has been the case with Superior.[177] Thus, Mr. Hafling argued that Superior's recent negative cash flows do not indicate future cash flows will be negative.[178]

Based on the evidence presented, I find Mr. Hafling's testimony to be persuasive. Therefore, I find that the Bureau fail to present clear and convincing evidence that Superior is in hazardous condition based singly on the standards of 14 VAC 5-290-30 (17).

**Combined Analysis**

Taking all of the standards of 14 VAC 5-290-30 into consideration on a combined basis, the analysis boils down to one issue. That issue is whether Superior will become profitable in the foreseeable future. If Superior fails to become profitable, adverse findings become a certainty, surplus will continue to decline, affiliates will be threatened with insolvency, and it will experience liquidity problems. Superior's trend of losses stretches back to 1998. As Bureau witness Stole observed "there is a reasonable expectation, given [Superior's] current financial position and the way it is trending, that it will become not only impaired, but insolvent."[179] Thus, properly framed the issue is whether the Bureau presented clear and convincing evidence that Superior's historic trends will continue.

In answering this question, I find that evidence presented by Superior concerning its change in management, increases in rates, and its demonstrations of how Superior may become profitable by the end of 2002 makes it ***less*** than clear and convincing that Superior's historic trends will continue. This finding is consistent with the actions Superior's state of domicile has taken regarding Superior. Florida has moved to stop dividend payments from Superior to its parents. In so doing, Florida has signaled that Superior is troubled, but has not moved to suspend its license. On the other hand, Florida has not tried to stop or delay actions taken by the Bureau.

[175] *Id.*
[176] Hafling, Tr. at 173-78.
[177] *Id.*
[178] *Id.* at 178.
[179] Stole, Tr. at 77.

Therefore, I find that the Bureau has failed to present clear and convincing evidence that Superior's continued operation in this Commonwealth is hazardous to its policyholders, creditors, and the public in this Commonwealth.

However, as discussed above, Superior's financial condition leaves little room for error or little time for trends to reverse. Therefore, Superior should be directed to file with the Bureau any RBC plans that it has or may file with Florida, as well as the monthly and quarterly reports it files with the Florida Insurance Department.

Accordingly, in accordance with the above findings, ***I RECOMMEND*** that the Commission enter an order that:

1. ***ADOPT*** the findings in this Report; and

2. ***DISMISSES*** this case from its docket of active matters.

**COMMENTS**

Pursuant to the Commission's Rules of Practice and Procedure, specifically Rule 5 VAC 5-20-120 C, the Bureau and Superior may file comments or exceptions to my findings and recommendations. Such comments may note a party's objections to any of the rulings, findings of fact or recommendations, and may offer remarks or clarifications regarding those findings and recommendations. Any comments to my findings must be filed with the Clerk of the Commission in writing in an original and 15 copies within 14 days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, Post Office Box 2118, Richmond, Virginia 23218. Any comments shall also include a certificate at the foot of the document certifying that copies have been mailed or delivered to all counsel of record.

Respectfully submitted,

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Alexander F. Skirpan, Jr.
Hearing Examiner